Supreme Court of the United States

October Term, 1897.

C. H. BOSWORTH, RECEIVER OF THE CHICAGO, PEORIA & ST. LOUIS RAILWAY,
Appellant,

vs.

TERMINAL RAILROAD ASSOCIATION OF ST. LOUIS, INTERVENING PETITIONER,
Appellee.

Brief of Petitioner.

STATEMENT.

This is an application by C. H. Bosworth, as receiver of the Chicago, Peoria and St. Louis Railway, for a Writ of Certiorari to be directed to the United States Circuit Court of Appeals for the Seventh Circuit, to review a decision of said court dismissing the appeal of petitioner from a decree of the United States Circuit Court for the Southern district of Illinois, directing the said C. H. Bosworth to pay to the Terminal Railroad Association the sum of $8,162.11 out of the income of said receivership, and in default thereof

out of the proceeds of the sale of the mortgaged premises, ahead of the mortgage debt.

That appeal grew out of the following state of facts:

On the 21st day of September, 1893, the Mercantile Trust Company of New York filed its Bill of Complaint in the United States Circuit Court for the Southern District of Illinois against the Chicago, Peoria and St. Louis Railway Company, praying a foreclosure of its mortgage; and the appointment of a receiver *pendente lite*. Thereafter, on the same day, an order was entered on this bill of complaint appointing C. H. Bosworth and E. Ellery Anderson receivers of the railroad and property of the said Chicago, Peoria and St. Louis Railway Company, clothing them with all the authority and rights usually given to receivers by courts of equity to take charge of and operate railroads in the general administration of the same for the benefit of mortgage creditors.

Among other things this order contained a direction to the receivers to collect and receive the tolls, rents, moneys, issues and profits of said premises and property, and out of the same equip, maintain and keep the property in good repair, and pay, among other things, (R. p. 25) "all claims for materials and supplies which have been incurred in the operation and maintenance of said property during the six months last passed and all tickets, trackage and traffic bal-

ances due from connecting railroads." To this, counsel for the Mercantile Trust Company objected, and upon argument the court overruled the objection.

On the 27th day of May, 1895, the Terminal Railroad Association of St. Louis filed its intervening petition in this foreclosure cause, and alleged that within the six months prior to the appointment of the receivers it performed certain labor and furnished certain materials for and to the defendant railway company, amounting in value to the sum of $8,162.11, and prayed that the same be allowed and ordered to be paid under the order of the court appointing the receivers. (R. p. 26.)

To this intervening petition the receivers on June 8, 1895, filed their answer, (R. p. 28) first saving all benefit and advantage of exception to the errors, uncertainties and imperfections in the petition, and then averring that the facts set forth in the petition might be true, but that they were utter strangers to the same, and could not form any belief thereon, and prayed strict proof thereof; and further answering, denied that the petitioner was entitled to the relief, or any part thereof demanded, and prayed the same advantage of their answer as if they had pleaded and demurred to the petition.

This intervening petition under a general order of reference went to Stuart Brown, as master in chancery, and he, after hearing certain evidence, made and

filed his report on January 6th, 1896, wherein and whereby he reported that he had examined the petition and answer and taken evidence, and found that there was due the petitioner, for labor and materials furnished, the sum of $8,162.11. and that such amount was a lien on the property of the defendant company, prior and superior to the claims of the mortgage bondholders, and that it should be paid out of the surplus income, or from a sale of the property. (R. p. 29.)

To this report, the receiver, on the 29th day of January, 1896, filed his exceptions (R. p. 30), and these exceptions were thereafter, on the 30th day of July, 1896, overruled by the Circuit Court; and a decree entered on the petition in conformity with the report of the master. (R. p. 31.) From this decree the receiver prayed and obtained an appeal to the Court of Appeals for the Seventh Circuit.

It is to be particularly noted that the trustee under the mortgage sought to be foreclosed by the proceeding in which the receivers were appointed, lost no time in taking active steps to pursue the remedy provided in default of the covenants of the mortgage, to be performed by the mortgagor. The bill to foreclose was filed just twenty days after default in the payment of the interest coupons attached to the bonds, (R. p. 5) and the court took immediate possession of the property through its receivers. (R. p. 22.) It is also to be noted that the intervening petitioner neither

averred in its petition nor proved that there had been a diversion of the income of the railway company from the payment of operating expenses to the payment of interest due on the mortgage bonds; nor in any way that the mortgage creditors, whose vested contract lien it sought to displace, had received possession of that which in equity belonged to the whole or a part of the general creditors. On the contrary, the petitioner relied entirely for its right to priority on the order of the Circuit Court, appointing the receivers for this property, directing them to pay all claims for materials and supplies incurred within the six months next preceding. (R. p. 26.)

The said appeal came on for hearing, was fully argued in the said Court of Appeals, and subsequently, on the 7th day of June, 1897, the said court handed down its decision dismissing the said appeal, on the principal ground that the receiver had no interest in the controversy and had no right to appeal from the decree of the Circuit Court which appointed him.

Thereafter, on the 25th day of June, 1897, the receiver filed his petition in said Court of Appeals for a re-hearing, but said petition was also denied.

Because of the importance of the question of practice as to a receiver's right to appeal, and the conflict between the decisions of the several Courts of Appeals on that question; and also because of the importance

of the question of law raised on the merits of the controversy, and of the conflict in the decisions of the several Courts of Appeals with this Honorable Court on that question, the receiver feels justified in presenting to this court a petition for a Writ of Certiorari to the said Circuit Court of Appeals for the Seventh Circuit.

The issue raised by the intervening petition of the Terminal Railroad Association filed in the original foreclosure cause, pending in the United States Circuit Court for the Southern District of Illinois, and the answer of the receiver to said intervening petition, is solely the right of the intervenor to have its claim paid out of the income in the hands of the receiver arising from the operation of the railway property. (R. p. 26, 27.) And although the only party made defendant to said intervening petition was the receiver, *and the only relief prayed was against the income*, nevertheless the said Circuit Court entered a decree not only directing the receiver to pay the demand out of the income, *but also directed that in default thereof, said demand should be paid out of the proceeds of the sale of the mortgaged premises ahead of the mortgage debt.*

Ever since the institution of this receivership the burden of defending these assaults on the receiver's possession, both of the property and income, has fallen entirely on the receiver, who has conducted the

same solely in his own name; and in every case which has been appealed the said Court of Appeals entertained the appeal, and disposed of the case on its merits.

See *Mather Humane Transportation Company vs. Bosworth, 76 Fed. Rep., 164.*

Hook vs. Bosworth, 64 Fed. Rep., 443.

Bosworth vs. National Bank, 64 Fed. Rep., 615; and *Bosworth vs. Francis Hook, 77 Fed. Rep. 686.*

It was not until the present case that the Court of Appeals decided the receiver had no interest in such controversies and no right to appeal; and in this case it dismissed the appeal *sui sponte* and characterized the issues raised by the pleadings and the errors assigned on the record as presenting merely moot questions.

The denial of this right to appeal involves an important question of practice and is directly in conflict with the decisions of the Courts of Appeals for the Fourth and Sixth Circuits, and we submit is manifest error.

The refusal of the Court of Appeals to dispose of this case on its merits and to reverse the decree of the Circuit Court for the Southern District of Illinois leaves the receiver no recourse save this application to this Honorable Court.

Assignment of Variance.

First.

The decision of the Court of Appeals for the Seventh Circuit is at variance with the decision of the Court of Appeals for the Fourth Circuit in this: That in the case at bar the court says:

> "By what right does he undertake to prevent the enforcement of this claim against the purchased estate, presumably by the decree of sale charged as a lien upon it. He has no such right. He is, in so doing, an interloper obtruding himself in breach of his duty where he has no right, and in a matter with which he is not concerned."

While in *Thom vs. Pittard, 10 C. C. A., 352*, the Court of Appeals for the Fourth Circuit says:

> "It is claimed that the receiver, the officer and servant of the court, subject to its orders, without personal interest in the funds under his control, which are to be accounted for as the court may direct, is not to be permitted to refuse to obey the court's orders by appealing from its decrees. But we must remember that the receiver represents all the parties in interest. He stands for the railroad company as well as for all persons having claims against it, and he speaks for the bondholders as well as for the stockholders. While he has no personal interest in the proceedings, except to faithfully and impartially discharge his duties, it is incumbent upon him to faithfully protect the property confided to his keeping; to report to the court all matters connected therewith relating to its safe keeping, and *proper disposition*; to obtain permission to sue for debts due, and leave to pay claims owing by him. *Permission given the receiver to sue, or direction to him to defend, should take with it the right to follow the suit to the court of last resort.*"

Second.

The decision of the Court of Appeals for the Seventh Circuit is at variance with the decision of the Court of Appeals for the Fourth Circuit in this:

That in the case at bar the court says:

> "Neither the trustee, nor the bondholders, nor the purchaser is here objecting; who made the receiver the guardian of their interests in this regard?"

While in *Thom vs. Pillard, 10 C. C. A. 352*, the Court of Appeals for the Fourth Circuit says:

> "But we must remember that the receiver represents all the parties in interest. He stands for the railroad company as well as for all persons having claims against it, and he speaks for the bondholders as well as for the stockholders."

And again, in the latter the court says:

> "While it is true that any of the defendants to said chancery suit, interested in the property of the railroad company, *and in its proper distribution*, as also the plaintiffs, *could have appealed* from said decree in favor of appellee, proper steps therefor having been taken, *still it does not follow that the receiver, who was in fact the defendant*, so far as the issues raised by the petition were concerned, *could not also appeal.*"

Third.

The decision of the Court of Appeals for the Seventh Circuit is at variance with the decision of the Court of Appeals for the Sixth Circuit in this:

That in the case at bar the court says:

> "By what right does he undertake to prevent the enforcement of this claim against the purchased estate, presumably by the decree of sale charged as a lien upon it. He has no such right. He is in so doing an inter-

loper, obtruding himself in breach of his duty where he has no right, and in a matter with which he is not concerned."

While in *Felton vs. Ackerman, 9 C. C. A., 457*, the Court of Appeals for the Sixth Circuit says:

> "While it is true that the receiver is an arm of the court in the administration of the property, yet, where persons intervene to obtain relief against him, because they cannot obtain full relief in any other forum, the issued raised by his answer to the petition makes the proceeding an adversary one, in which the receiver *represents the interests of the owners of the property*, of which he is temporarily in charge. If, *as such representative*, he feels aggrieved by an order of the court made in an adversary proceeding of this character, it is difficult to see why he should not be permitted to have the order of the court reviewed by the appellate tribunal to which any other litigant may resort. Certainly the owners of the property, if aggrieved by the order against the receiver, *might appeal, and there would seem to be no justice in preventing the temporary custodian of their property from doing so.*"

Assignment of Error.

First.

The Court of Appeals for the Seventh Circuit erred in dismissing the appeal of C. H. Bosworth on the ground that he had no interest in the controversy, for the reason that the intervening petition prayed relief against the said Bosworth, and the issue raised by the answer thereto made the proceeding an adversary one, in which the said Bosworth represented the interests of whomsoever might be ultimately adjudged to be entitled to the estate of which he was temporarily in charge as such receiver.

Second.

The Court of Appeals for the Seventh Circuit erred in dismissing the appeal of C. H. Bosworth on the ground that he had no right to appeal from the decree of the Circuit Court for the Southern district of Illinois, for the reason that the said Circuit Court expressly authorized and directed the said Bosworth to prosecute said appeal.

Third.

The Court of Appeals for the Seventh Circuit erred in dismissing the appeal of C. H. Bosworth on the ground that he had no right to appeal, for the reason that it is incumbent upon him to carefully protect the property confided to his keeping as receiver, and the right to sue or defend carries with it the right to follow the suit to the court of last resort.

Fourth.

The Court of Appeals for the Seventh Circuit erred in dismissing the appeal of C. H. Bosworth on the ground that he had no interest in the controversy, for the reason that the said C. H. Bosworth, as receiver, represents all the parties to the original foreclosure cause, as against the parties who may attempt, by a separate and distinct action, to diminish and segregate the estate which he was appointed to conserve.

Fifth.

The Court of Appeals for the Seventh Circuit erred in dismissing the appeal of C. H. Bosworth on

the ground that he did not represent the parties to the original foreclosure cause as against the Terminal Railroad Association, a stranger thereto, attempting to diminish and segregate the estate in controversy between the parties to the original cause.

Sixth.

The Court of Appeals for the Seventh Circuit erred in deciding that the receiver represented the Terminal Railroad Association as well as the mortgagee in the protection and safe keeping of the income of the receivership and the property in controversy between the parties to the original foreclosure cause.

Seventh.

The Court of Appeals for the Seventh Circuit erred in failing and refusing to decide that *prima facie* the mortgagee was entitled to the property in litigation and to the income of the receivership, and that, as to the protection and safe keeping of the same, the receiver represented the mortgagee as against the Terminal Railroad Association.

Eighth.

The Court of Appeals for the Seventh Circuit erred in failing and refusing to decide that the receiver, in the care and custody of the property, represented solely the parties to the original foreclosure cause, until some other party by intervention acquired a

substantial, prior or equal right therein by a final adjudication in a court of last resort.

Ninth.

The Court of Appeals for the Seventh Circuit erred in concluding it to be conceded that the debt in controversy was a just claim against the *estate* from the statement in appellant's brief that there was "no controversy as to the labor having been performed or the material furnished within the six months next prior to the appointment of the receiver of the insolvent corporation, nor as to the value of the same," for the reason that such language can only be construed to concede the claim to be just as against the defendant railway company.

Tenth.

The Court of Appeals for the Seventh Circuit erred in assuming as the basis for its judgment "that prior to the decree appealed from, the railway had been sold under decree of sale and has passed out of the possession of the receiver and into the possession of the purchaser, and also that the receiver had not in hand moneys with which to pay the debts adjudged," for the reason that the record in the cause is wholly silent as to such facts.

Eleventh.

The Court of Appeals for the Seventh Circuit erred in failing and refusing to reverse and annul the

decree of the Circuit Court for the Southern District of Illinois.

Twelfth.

The Court of Appeals for the Seventh Circuit erred in failing and refusing to decide that before the Terminal Railroad Association was entitled to have its claim paid out of the income of the receivership it should allege and prove that the income arising from the current earnings of the railway company was diverted from the payment of current expenses to the payment of the mortgage debt.

Thirteenth.

The Court of Appeals for the Seventh Circuit erred in failing and refusing to decide that before the Terminal Railroad Association was entitled to have its claim paid out of the proceeds of the sale of the mortgaged premises, ahead of the mortgage indebtedness, it should allege and prove that the net income arising from the operation of the property by the receiver, after paying all necessary operating expenses, was applied to the betterment of the mortgaged property.

Fourteenth.

The Court of Appeals for the Seventh Circuit erred in failing and refusing to decide that even if there had been such a diversion of the income arising from the current earnings of the railway company, or from the current earnings of the receiver, the amount of restoration depends upon the amount of diversion,

and before the Terminal Railway Association was entitled to have its claim paid out of either the income of the receivership or the proceeds of the sale of the mortgaged premises, it should have alleged and proved that the amount so diverted aggregated at least the amount of its claim.

Fifteenth.

The Court of Appeals for the Seventh Circuit erred in failing and refusing to decide that the Terminal Railroad Association had neither alleged nor proved that the income arising from the current earnings of the railway company was diverted from the payment of current expenses to the payment of the mortgage debt, principal or interest.

Sixteenth.

The Court of Appeals for the Seventh Circuit erred in failing and refusing to decide that the Terminal Railroad Association had neither alleged nor proved that the net income arising from the operation of the property by the receiver was diverted to the betterment of the mortgaged property.

Seventeenth.

The Court of Appeals for the Seventh Circuit erred in failing and refusing to decide that the Terminal Railroad Association had neither alleged nor proved that the mortgage bondholders had received that which in equity belonged to the general creditors of the railway company.

Eighteenth.

The Court of Appeals for the Seventh Circuit erred in failing and refusing to decide that the Terminal Railway Association relied wholly, for its right of recovery, on the order appointing the receiver, directing him to pay certain claims; and in failing and refusing to decide that such order alone is not a sufficient ground of recovery.

Argument.

The questions presented by this application are: *First*, is this a proper case for the exercise of the power of this court in certiorari? If this is determined in the affirmative, then; *Second*, did the Court of Appeals for the Seventh Circuit err in denying to the petitioner a right of appeal? *Third*, is an unsecured creditor of an insolvent railway company entitled to priority over the mortgage bondholders, either in the income of the receivership, or the proceeds of the sale of the mortgaged premises, without alleging and proving a diversion of income?

FIRST.

This Is a Proper Case for the Issuing of a Writ of Certiorari.

The Act of Congress, approved March 3d, 1891, creating the Circuit Court of Appeals, expressly pro-

vided, by its Sixth Section, for a review by the Supreme Court, in the following language:

> "And excepting, also, that in any such case as herein before made final in the Circuit Court of Appeals, it shall be competent for the Supreme Court to require, by certiorari or otherwise, any such case to be certified to the Supreme Court for its review and determination with the same power and authority in the case as if it had been carried by appeal or writ of error to the Supreme Court."

In the very late case of *Forsyth vs. City of Hammond* (decided April 9th, 1897) the Supreme Court, in response to a contention of lack of power to take cases by certiorari, said of this section of the act that:

> "The general language of this clause is noticeable. It applies to every case in which, but for it, the decision of the Circuit Court of Appeals would be absolutely final, and authorizes the court to bring before it for review and determination the case so pending in the Circuit Court of Appeals, *and to exercise all the power and authority over it which this court would have in any case brought to it by appeal or writ of error.* Unquestionably the generality of this provision was not a mere matter of accident. It expressed the thought of Congress distinctly and clearly, and was intended to vest in this court a comprehensive and unlimited power. * * * * All that is essential is that there be a case pending in the Circuit Court of Appeals, and of those classes of cases in which the decision of that court is declared a finality, and this court may, by virtue of this clause, reach out its writ of certiorari and transfer the case here for review and determination."

Fully appreciating the fact that "a power so broad and comprehensive, if carelessly exercised, might defeat the very thought and purpose of the Act creating the Courts of Appeal," we shall endeavor to

show that the case at bar comes within the narrow limits early prescribed by the Supreme Court for the exercise of this power.

In *ex parte Lau Ow Bew, 141 U. S., 583*, this court announced that one of the grounds upon which it would exercise this power was in cases in which the question involved was one of gravity and importance. And in *Forsyth vs. City of Hammond, supra*, it said:

> "That while this power is co-extensive with *all possible necessities* and sufficient to secure to this court a *final control over the litigation in all the Courts of Appeal*, it is a power which will be sparingly exercised, and only when the circumstances of the case satisfy us that the importance of the question involved, *the necessity of avoiding conflict between two or more Courts of Appeal*, or between Courts of Appeal and the courts of a State, or some matter affecting the interests of this nation in its internal or external rélations, demands such exercise."

The circumstances which we contend exist to warrant the exercise of this power, are (1) the importance of the question involved, and (2) the conflict of the decision in this case, with the decisions of the Courts of Appeals for the Fourth and Sixth Circuits.

(a) The importance of the questions involved justifies a review by this court.

The ground upon which the Court of Appeals dismissed the appeal involves a far-reaching question of practice, *i. e.*, the right of a receiver to appeal from a decree of the court which appointed him. It was contended by the receiver that this question was

definitely settled in favor of the right to appeal by the decision of the Supreme Court in the case of *Farlow vs. Kelly, 131 U. S. Append. c. c. i;* but this contention was not accepted by the Court of Appeals. If the Court of Appeals is right upon this point then the trial and intermediate courts have nothing but the principles of pleadings and practice to guide them in the disposition of such a question, since no other case in the Supreme Court can be found which touches the question.

It might be suggested that principles and not adjudication is the proper basis for a judgment, but on this very question we have a very natural result of a determination reached in that manner, *i. e.*, a conflict between the decisions of the only three Courts of Appeals to whom the matter has been submitted. It is, therefore, we contend that if the question is of sufficient importance, the very fact that the Supreme Court has never passed upon it is one of the most urgent reasons why the case should be certified to it for determination.

Is it of sufficient importance? Considered in relation to railway litigation alone it will be remembered that since 1893 eighty per cent. of the mileage of American railroads has been in the hands of receivers, and when a railroad is in the hands of a receiver its litigation tends rather to increase than to diminish. As to all questions save those arising directly between

the mortgagor and mortgagee, it has been the custom to refer them to the receiver appointed to conserve the property; in fact, the very nature of a receiver's duties demand that he shall protect his trust either by defense or prosecution; and this necessarily devolves upon the receiver a great mass of litigation. Is it not of the utmost importance then that the rules of practice governing such litigation should be definitely and authoritatively determined? We submit that if this was the only feature in the case it alone would justify the court in taking this case.

(b) The necessity for unanimity in the decisions of the various Courts of Appeals also justifies a review by this court.

In addition to the importance of the question involved, we have here a conflict in the decisions of the Courts of Appeals which has been recognized as a most potent reason for a review by this court. *Forsyth vs. City of Hammond, supra.*

In April 1894, the right of a receiver to appeal seems first to have been attacked in the Federal courts. This occurred in the Sixth Circuit, and is reported in the case of *Fellon vs. Ackerman, 9 C. C. A., 457, s. c. 61 Fed. Rep., 225.* There a receiver appealed from the order of the court by which he had been appointed, granted upon intervening petition, and restraining him from obstructing a road which the court found to have been improperly vacated. The court at once

held not only that it was consonant with the relations which ought to exist between a receiver and the court appointing him, but also that as the representative of the owners of the property he was temporarily in charge, justice demanded that he should be entitled to have the order of the court which affected their interests reviewed.

Following closely upon this decision, in point of time, we find the next attack in the Fourth Circuit, reported in *Thom vs. Pittard, 10 C. C. A. 352, s. c. 62 Fed. Red. 232*, decided the very next month—May, 1894. *This was also unsuccessful*, and we find these two circuits in harmony. Here the ground assigned was that the receiver was not in fact a party to the suit; had no interest in the disposition of the funds and property under his control, and therefore had no right to appeal from a decree disbursing or distributing the same.

In conflict with these two decisions of the Fourth and Sixth Circuit Courts of Appeals announcing a receiver's right to appeal, we have the decision of the Court of Appeals for the Seventh Circuit denying such right. It is true that in the opinion of the latter court it is asserted that it agrees with the Court of Appeals for the Fourth Circuit, *but we submit that its judgment in dismissing the appeal on the very ground that the receiver had no right to appeal is controlling*

as to whether the two decisions are in conflict. In one the appeal is *sustained*, and in the other it is *dismissed.*

SECOND.

A Receiver's Right to Appeal Is Sustained by Principle.

If this court is of the opinion that this case is a proper one for review, the question which then presents itself is, did the Court of Appeals err in dismissing the appeal? We submit that not only the weight of authority is against the conclusion reached by it, but also that such authority has for its foundation sound reasoning.

(a) A receiver is appointed to protect the estate for whomsoever may be ultimately entitled thereto.

Inasmuch as one of the grounds assigned by the Court of Appeals for dismissing the appeal was that the receiver has no interest in the controversy, it becomes important to ascertain what interest a receiver has in the estate he is temporarily in charge of, since the controversy in question grew out of an attempt to diminish and segregate that estate.

In the early case of *Fosdick vs. Schall, 99 U. S., 235*, this court announced:

> "He holds, pending the litigation, for the benefit of whomsoever in the end it shall be found to concern, and in the meantime the court *proceeds to determine the rights of the parties upon the same principles it would if no change of possession had taken place.*"

Primarily, and of necessity, until the end of the original litigation, when it may be definitely ascertained which of the parties is entitled to the property, he is the representative of the estate. As betwen the parties to the original controversy, *i. e.*, the foreclosure of the mortgaged estate, he cannot be said to represent one as against the other, but he represents both.

This representative character is well expressed in *Booth vs. Clark, 17 Howard 322*, where it is said:

> "The receiver is an indifferent person between parties, appointed by the court to receive the rents, issues or profits of land or other thing in question in this court, pending the suit, where it does not seem reasonable to the court that either party should do it. *Wyatt's Practice Reg., 355.* He is an officer of the court, his appointment is provisional. He is appointed in behalf of all parties, and not of the complainants or defendants only. He is appointed for the benefit of all parties who may establish rights in the cause."

As between the two original parties, mortgagor and mortgagee, he stands indifferent; but not so as to the two original parties on one side and a stranger (to the original action) on the other side, attempting to wrest a portion of the subject of the original controversy away from both the original parties. In such a conflict he represents the one of those original

parties who may be ultimately entitled to a prior right in the subject matter of controversy. *When this conflict is ended and the stranger is finally* adjudged to have a right prior to either of the original parties, then it may be said that another party has established a right in the controversy, and the receiver then represents also that party in any subsequent conflict with another stranger. And thus on, as strangers establish rights in the cause, the receiver becomes their representative. But we insist that *by the mere intervention in the original cause no right is established,* and that it is the duty of the receiver, as the custodian of the property, to defend against such assaults to the Court of last resort, and that no right is established until the demand is either admitted or finally adjudicated in a Court of last resort.

This distinction has been clearly recognized in the case of *McLeod vs. The City of New Albany, 66 Fed. Rep. 378,* where, in determining the matter presented on appeal, it was necessary for the court to define who a receiver represented in respect to the conservation of the property for which he was appointed. There the court held, at page 381, not that he represented *every* party who might come into the original cause *by intervention,* but that he represented the parties to the *original bill.*

(b) If any presumption is to be indulged as to which of the original parties the receiver represents, it is in favor of the mortgagee.

It is not to be overlooked that this receiver was appointed on a bill filed by the mortgagee to foreclose this estate, and therefore there is a great distinction between cases of this kind and cases where a receiver is appointed at the instance of the insolvent corporation itself, or to wind up the affairs of a corporation, or to dissolve a partnership. In the one case the court takes possession of the property through its receiver for the purpose of subjecting it to a decree of foreclosure and sale; in another case the court takes possession of the property for the purpose of keeping it intact so that it may the better discharge its public duties; in another case, the court takes possession of the property for the *very purpose* of dividing it between *all classes of creditors.*

Therefore, with this distinction in view, we submit that in a case of this kind where a stranger has intervened, if any presumption is to be indulged as to which of the original parties the receiver represents in a conflict with a stranger, the presumption is that he represents the mortgage bondholders. The very fact that a court will take possession of the estate is conclusive of the *prima facie* case thus made by the complainant in an action to foreclose its mortgage; so that, primarily, the court holds the property

through its receiver to satisfy the debt of the mortgagee, and as between the mortgagee and an unsecured creditor, it is certainly a mild presumption that the former is entitled to the estate which the receiver is conserving.

As between the mortgagor and mortgagee, this presumption is recognized in that class of cases in which it is held that until default or the actual possession of the estate by the mortgagee, through a receiver, the income of the property belongs to the mortgagor, to do with it as it sees fit. This warrants the strong presumption that after the mortgagee has moved and has, by the appointment of a receiver, subjected the estate to the forfeiture provided for in the mortgage, that *prima facie* at least, the income derived from the property by the receiver belongs to the mortgagee, and that the acts of the receiver in defending an assault upon such income are *prima facie* in the interest and for the benefit of the mortgagee.

(c) By intervention the appellee attempted to diminish the estate which the receiver was appointed to conserve.

By reference to the intervening petition (R. p. 26) it will be seen that the only prayer is that the receiver pay to the intervener a certain sum out of the income of the receivership. No one can question but that the receiver was appointed just as much for the

purpose of conserving the income as the *corpus* itself; the mortgagee claimed, under its bill of complaint, the income just as much as it claimed the *corpus*.

Then is not a proceeding, the only object of which is to obtain a portion of the income, an attempt on the part of the intervener to diminish the estate which the receiver is appointed to conserve? Is not this attempt to acquire a portion of the income just as much an attempt on the part of the stranger to divest the receiver of his possession of the estate as though the intervener had claimed a portion of the right of way upon which the railroad track was built? We submit that it is.

If it is the duty of a receiver to resist an attempt to divest him of certain portions of right of way, then, surely, it is as much the receiver's duty to resist this attempt to acquire a portion of this income. And we respectfully submit that in carrying such resistance to the Court of last resort the receiver does not make himself a partisan as between the real parties to the issue before the court in the cause in which he is appointed, viz., the foreclosure of the mortgage; but that he is doing all in his power to conserve the whole estate for whomsoever shall be ultimately entitled to it, and that thereby he is doing what was expressly approved in *McLeod vs. City of New Albany, 66 Fed. Rep,, 378*, viz., to contest the right of a

stranger to participate in this estate, and thus diminish it.

(d) His duty is to defend the estate against all claims which he deems to be unjust.

In the opinion rendered by the Court of Appeals in the case at bar it is said of the receiver that "*his duty is to defend the estate against all claims which he deems to be unjust.*" But in applying that principle to the case at bar the court seems to have misapprehended a most material fact, since it concluded, we think erroneously (Opinion p. 4),

> "That this debt was a just claim against the estate is not doubted *and is conceded.*"

The receiver admitted the claim to be just as against the *railway company*, but *expressly* denied it to be just as against the *estate*. This distinction is vital. To be just against the railway company it need only appear that the services were performed, the material furnished, and that the value was reasonable; but to be just against the estate *it must also appear that for the payment of this demand out of the estate the intervener must bring himself within the well defined limits prescribed by the Supreme Court.* The right of participation is the very right which the receiver has always denied, and his attitude in this respect throughout the whole litigation has been consistent.

When the intervention was first filed the receiver did not deny the claim as against the railway com-

pany, but asserted that even admitting all the facts alleged by the intervener, still it was not entitled to have its demand paid *out of the estate.* This was the substance of the receiver's answer. It was on the issue thus raised that the matter was submitted, first to the master and then to the Circuit Court. *No one then denied the receiver's right to resist this claim.* If he could resist it before the master and in the Circuit Court, *why can he not resist it in a Court of Review?*

This resistance is in the performance of his duty to defend the estate against all claims, and is in accord with one of the late decisions of the same Court of Appeals.

In *McLeod vs. The City of New Albany, 66 Fed. Rep., 378,* a case absolutely on all fours with this case, the Court of Appeals announced most emphatically not only that it was the duty of the receiver to preserve the estate, but that on an appeal from a decree of the lower court adjudging the claim of an unsecured creditor to be prior to that of the vested contract lien, *the receiver could not object that the original parties to the foreclosure clause were not parties to the appellate proceedings, because he, the receiver, represented them in the Appellate Court,* for the purpose of contesting the claim, and further, because the original parties were not in that Appellate Court objecting that they were not *well* represented.

The facts in the *McLeod case* are so nearly identical with the facts in the case at bar that we feel justified in here presenting an abstract.

McLeod was appointed receiver of the property of the Kentucky and Indiana Bridge Company in a suit brought against it and the trustees of its mortgage by the Youngstown Bridge Company. In this suit *an unsecured creditor*, the City of New Albany, filed its intervention for the payment of taxes accrued *prior to the receivership*, and prayed that the same be paid out of the funds in the hands of the receiver prior to the claim of any other creditor.

This intervention was referred to a master in chancery, who reported in favor of the unsecured creditor. The receiver excepted to this report, but his exceptions were overruled, the master's report confirmed, and the lower court entered a decree directing the receiver to pay the amount found due. From this decree the receiver appealed to the Seventh Circuit Court of Appeals.

Among other errors assigned was a defect of proper parties. The receiver urged not only that the mortgagee should have been made a party, but also all of the parties to the *original* suit. This contention presented fairly and squarely the question as to whether or not the receiver had sufficient interest, in a controversy between various creditors, claiming priority over each other, out of the estate for which he

was appointed to conserve, to present the matter for final determination to the Court of last resort; or whether or not it was necessary that the particular party whose lien was sought to be displaced should have been made a formal party to the intervening petition in the lower court, and have appealed from its decision, if the same displaced its lien. And in that case the court *decided that very question*, and not only held that it was the duty of the receiver to resist the payment of the taxes out of the estate which he was appointed to conserve, but went further and held that the receiver had sufficient interest in the matter *to fully represent on appeal the parties to the original cause*, whose vested lien the intervener was attempting to displace.

The language used by the court in arriving at the above conclusions (page 381) is:

> "The other parties whose presence is suggested as essential *are parties to the original bill* as holding incumbrances upon the property subordinate to the lien of the complainant. They were in court in the suit in which the receivers were appointed, and were bound to take notice of the intervening petition of the city filed in that suit, and of the proceedings thereunder. It was not necessary that they should be made formal parties to the petition. Being parties to the suit, they were in fact parties to the intervening petition. The receivers in respect to the conservation of this property *represent all parties to the original bill*. It was their duty to preserve the estate and thereto to pay the taxes thereon. If the taxes were illegally paid, it was their duty, representing all in interest, to contest payment. If parties to the original bill desired to take active part in such contest they had a right to be heard, and such right, if demand-

> ed, would doubtless have been accorded to them. They did not so ask, although being parties to the suit they were obligated to take notice of the proceedings. *They are not here objecting that they were not well represented by the receivers.* The latter cannot for the first time, after full hearing upon the merits before the master, object *that those they represented* should be formally notified of the petition."

If, therefore, as that court above holds, *that a receiver cannot object* that the parties whose lien the intervener seeks to postpone is not a *formal* party, upon what principle of justice *can the intervener* set up such a purely technical defense; if that court will not sustain the contention that the receiver does not represent all the parties to the original bill, *when made by the receiver*, why will it sustain the same contention *when made by an unsecured creditor?*

Can it be said that the claim of the City of New Albany for taxes in the *McLeod case* differs in character from the claim of the Terminal Railroad Association in the case at bar, for materials furnished? Both are unsecured creditors whose demands accrued prior to the receivership, and the intervening petitions of both seek a priority over the vested contract lien of the mortgagee, and seek payment of the same out of the estate in the hands of the receivers. Or is there such a difference even in degree, which would sustain the vital distinction that in the first case the receiver has sufficient interest in the estate to warrant his appealing from a decree which would diminish that

estate, *and in so appealing he represents all of the parties to the original bill*, while in the latter case he has neither the interest nor represents the parties to the original bill, who claim to be ultimately entitled to the estate he was appointed to protect?

We now beg respectfully to direct the court's attention to a number of cases in which that Court of Appeals has clearly recognized and sanctioned this very receiver's right to appeal from an order of the lower court, which diminished the estate he was appointed to protect, *and which declared "the respective equities of the parties to the suit," as that term is applied in the opinion in this case.*

Mather Humane Transportation Co. vs. Anderson, 76 Fed. Rep., 164, arose in this very foreclosure suit; the lower court entered a decree disallowing intervener a priority over the mortgage lien for car rentals; from this decree intervener appealed to that Court of Appeals, *making only the receiver appellee.* In disposing of the case this court permitted the receivers to resist intervener's right to priority and sustained their contention in that regard. *No other parties were before the court.*

Hook vs. Bosworth, 64 Fed. Rep., 443, was also a controversy which grew out of this same foreclosure proceeding. In that case Mr. Justice Jenkins, speaking for the Court of Appeals, even went so far as to

hold that Bosworth represented *solely* the trustee of the bondholders in a litigation which sought to subject certain earnings of the defendant railway company, which accrued prior to the appointment of the receiver, to the lien of the mortgagee. In view of the fact that the receiver there contended that he not only represented the bondholders, but also the general creditors of the company, this holding becomes more significant, inasmuch as the court, to prevent the recovery of those prior earnings by the receiver, based its conclusion that the receiver represented *only the trustee*, on the fact that he did not represent the general or unsecured creditors; and so in the very beginning of the litigation arising out of this foreclosure, the Court of Appeals emphatically and unqualifidely indicated to this receiver that he represented the trustee of the bondholders, and no one else.

There, William S. Hook and Marcus Hook, as officers of the railway company, after the receiver had been appointed, collected moneys from the Federal Government for the transportation of mails by the railway company. The receiver, conceiving himself to represent both the secured and unsecured creditors, and the money to be a part of the estate for which he was appointed to conserve, filed a petition against the Hooks to recover the same. The lower court sustained the receiver's position, but was reversed by

this court on the theory that the receiver *represented solely the trustee*, as is shown by the following language from the opinion at page 449:

> "So that the complainant trustee, *or the receivers as its representatives*, have no right to the earnings prior to the filing of this bill. * * * * What right the receivers would have to the fund earned prior to the filing of the bill, *if they represented judgment creditors*, we do not find it necessary to determine. As we have before observed, the record discloses that certain intervening petitions, cross-petitions and bills (some of them filed in the cause of the Mercantile Trust Company against the St. Louis & Chicago Railway Company, of the nature of which suit we are not informed) were ordered to be consolidated with the principal cause for the foreclosure of the trust deed or mortgage. The record is wholly silent with respect to the nature of those petitions, cross-petitions and bills, and to the character which the petitioners, cross-petitioners and complainants therein assumed. We are only told that those proceedings. whatever they were, were consolidated with the principal suit. * * * *We are, therefore, unable to say that the appellees (receivers) represent creditors as well as the trustees.* We can not, therefore, adopt the suggestion of counsel that these intervening petitions, etc., represent 'labor, supply and traffic balance creditors.' The fact does not appear from the record. We cannot assume it.
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> * * * * * * * * *
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> "It would seem inequitable, under such circumstances, that they should be called upon to respond to the receivers for the amount so paid, *unless possibly* it might be claimed that *they had no right*, after the appointment of receivers, to receive or to so disburse the monies *as against representatives of creditors*, appropriating it wholly to the payments of debts of their selection, when the debts discharged had only right to share ratably with other indebtedness of the corporation. *We are*, however, from this record, *unable to regard these receivers as representatives of others than the trustees of the mortgage*, who is not entitled to the earnings prior to the receivership."

Can it be said that the position in which the Court of Appeals thus placed the receiver at the beginning

of the litigation which arose out of this foreclosure, is in harmony with the position it assigns to him in the case at bar? If not, can it be said that circumstances have arisen which warrant such a radical change? We respectfully submit that as far as the conditions appear from this record they are identical in every detail as those which were disclosed by the record in *Hook vs. Bosworth, supra*, and although that court may personally have known that a sale and transfer of the property had taken place, we submit that this case should be decided on the record just as *Hook vs. Bosworth* was. *There the Court said it would not take the suggestion of counsel as to any fact which did not appear in the record*—that it could not "assume it." *And for the reason that certain facts did not appear in the record, it there held the receiver to represent solely the mortgagee.*

If the right of the interventer has been fortified by proceedings subsequent to the filing of its petition, and the record does not contain the same, it is the duty of the intervener to suggest a diminution of the record. The Court cannot assume it.

(*Distilling Co. vs. McNulta, 77 Fed. Rep., 415.*)

Another case in which that court recognized and sanctioned the receiver's right to resist to the Court of last resort, the effort of an unsecured creditor to displace the vested lien of the mortgagee, is *Bosworth vs. National Bank, 64 Fed. Rep., 615.* In that case the

bank filed its intervening petition in the foreclosure cause, alleging an indebtedness to it by the railway company of $10,000, upon which $2,500 had been paid in cash, and the balance by two drafts drawn on a traffic balance due from another railroad; that the payment of these drafts had been stopped by the receiver, and thereupon prayed an order directing the receiver to pay the same. The Court of Appeals says:

> "The claim on the part of the bank is that the drawing of the drafts constituted an appropriation in equity to that extent of the said funds in the hands of the drawee, which gave the bank a lien thereon *pro tanto* in *preference to other creditors*, although said drafts were never accepted or paid by the drawee."

So it is, therefore, to be seen that in that case also, we have a stranger to the original bill intervening in the cause, and claiming the right to have his debts paid out of the estate in the hands of the receiver, ahead of all other creditors. The receiver, while not questioning the validity of the debt as against the railway company, considered it his duty to resist the payment out of the estate in his hands. His position is thus stated by the Court of Appeals:

> "The contention on the part of the receivers is that inasmuch as the drafts were not presented or accepted, or the money paid before the railway went into the hands of receivers, and the money was then paid over to the receivers on demand, no lien attached to the money in the hands of the drawee, and that the receivers hold it as trustees for the benefit of the railway company and its general creditors."

The Circuit Court sustained the contention of the bank, viz.: that it had a lien prior to all other creditors, and directed the receivers to pay it $7,500 out of the estate in their hands. Was not this a decree distributing the assets of the insolvent corporation between conflicting creditors and giving one a right prior to all others? Yet from this decree the receivers appealed, and the Court of Appeals not only sustained the appeal, but went further and maintained the position that the receivers represented the bondholders, the railway company and all other creditors *as against this particular creditor*, and reversed the decree of the lower court, directing it to enter one in favor of the receivers. The Court says (page 618):

> "The receivers stand in the place of the administrator in the Massachusetts case, *and represented not only* an insolvent debtor, but *all* of its creditors as well, whose rights attached to the fund upon their appointment, and before any appropriation of the portion thereof represented by the drafts had been effected by presentation or acceptance, and even before the fund became due and payable by agreement of the railway companies."

So it appears from these two decisions of this Court of Appeals (*Hook vs. Bosworth* and *Bosworth vs. Bank*) that *it is immaterial whether a receiver represents only the mortgage trustee, or all creditors, secured or unsecured, and that in either event it is his right and duty* for the preservation of the estate in his hands for whomsoever may be ultimately entitled thereto *to resist the diminishing of that estate* by the payment to a general creditor in priority over all other creditors.

Passing now to the next case in which this Court of Appeals has recognized and sanctioned this receiver's right to appeal from an order of the court appointing him, which directs the distribution of the assets of the insolvent corporation, we come to *Bosworth vs. Francis Hook.* The opinion in this case was handed down in January, 1897, and reported in *77 Fed. Rep., 686.* In that case Francis Hook filed her intervening petition in the original foreclosure cause, alleging that the receivers had taken possession of one hundred gondola cars, upon which she had a lien prior to all other creditors, securing the payment of a promisory note of the railway company for $11,070 held by her. The petitioner prayed the payment of this amount out of the estate in the hands of the receiver, or in default, for the surrender of these particular cars, which were also in the hands of the receiver.

On these facts, we again submit that that case also was an attempt on the part of one creditor to obtain a priority over other creditors of the estate, and that when the Circuit Court entered its decree directing the receiver to pay the intervener the amount in question, out of the funds in his hands, within a specified time, that such was a "decree declaring the respective equities of the parties to the suit," *not the parties to the original suit,* but parties to the suit *as that term is used and applied in the opinion (p. 4) of the Court of Appeals in the present case.* Again in that case, the re-

ceiver felt it was his duty to take the judgment of the Court of last resort, and so he prayed and perfected an appeal from the order which thus diminished the estate and directed him to part with a portion of it.

Did this Court of Appeals in that case say to the receiver that he had no right to appeal from that order; that he was as much a representative of Francis Hook as of the mortgagee; that he should, as between these two parties, be indifferent and not a partisan; that his duty was to all in common, that he should not become the advocate of one against the other? No such position was there taken by the Court; but, on the contrary, the Court of Appeals again not only sanctioned the receiver's appeal, *but upon it alone*, reversed the lower court and directed it to enter a decree dismissing the intervening petition.

If this right to appeal had not been declared by other courts, we submit that its recognition by this Court of Appeals in all the litigation which has heretofore grown out of this particular foreclosure proceeding is full justification of the continuance of that practice in this particular Court by this receiver under the advice of his counsel.

(e) Is not the demand of an unsecured creditor for priority just as much a claim asserted against the whole estate as one growing out of the negligence of a receiver?

In distinguishing this case from *Thom vs. Pittard, 8 U. S. App. 597*, the Court of Appeals in its opinion (p. 3) says:

> "This right and duty should, however, be limited in its exercise to those cases in which the estate, as a whole, is interested to enforce a right or to defend a claim asserted."

That was a case in which an employee of the receiver sued him for a personal injury and recovered a judgment, from which the receiver appealed. The argument against the right to appeal in that case is identical with the arguments of opposing counsel in this case. We submit that in attempting to compel the receiver to respond in damages for the injuries sustained, *the employee was not asserting a demand which was in any sense more* against the whole estate, than an intervener who seeks to have his unsecured debt paid out of the estate in the hands of a receiver. *Prima facie*, that estate, both the *res* and the income, belong to the mortgagee, and any decree or judgment which directs the receiver to pay money out of it diminishes it to that extent, and the estate, as a whole, is just as much interested in defending against one claim as against the other.

The claimants in both instances are strangers to the original litigation and both seek to diminish, to the extent of their claims, the subject matter of the original controversy. If it is not necessary for the parties to the original controversy to appeal from the demand of one, upon what theory should they be compelled to appeal from the demand of the other? Both are seeking to particpate in the estate which the re ceiver has undertaken to preserve for the application of the decree which shall be entered on the determination of the issues made between the parties to original bill, *not on any issue which may be raised by the claim of some stranger to participate in the estate.*

(f) The Court Appointing the Receiver Made Him the Guardian of the Interests of Whomsoever Should be Ultimately Entitled to the Estate.

At page 4 of the opinion the Court of Appeals says that neither the trustee, bondholders nor purchasers are in court objecting, and therefore asks who made the receiver guardian of their interests. Our reply is that when the bondholders, through their trustees, filed their bill to foreclose a certain mortgage, they represented to the Circuit Court, that by virtue of a certain contract they were entitled to have all of the property of the railway company sold to pay their certain indebtedness. The issues raised by this claim could not be determined at once, and for the purpose

of preserving that property, so that if the court found the issues for the bondholders, this property would be in its possession to sell for their benefit; and so that also if the court found the claim of the bondholders was not sustained, it could restore the property to the company. It was, therefore, that the court entered an order directing the receiver to take possession of this property and, *primarily*, to preserve it for whosoever should be ultimately entitled to it, as would follow from a determination of the issues raised on the bill and answer.

(g) In appealing from an order which diminishes the estate the receiver is not necessarily solely asserting the right of one creditor over another.

The theory upon which this receiver did appeal in this case, and in all of the cases arising out of this foreclosure above referred to, is that it was his duty to preserve the estate as against all strangers to the *original controversy*, and that as to the equity of any decree which was entered on an intervening petition directing him to part with a portion of that estate, he should have the judgment of the court of last resort. As to any controversy between the parties to the original bill he had no interest; *but as to a controversy between a stranger to the cause and the estate*, he had a well defined interest, and was in duty bound to resist to the utmost the assertion of any claim which

would diminish that estate. And we earnestly contend that the fact that the stranger, attempting to get possession of a portion of the estate, happens to be an unsecured creditor, and bases his demand on some equity supposed to be prior to that of the original parties, does not necessarily make the action of the receiver, in defending the estate, the assertion of the right of one creditor over another.

(h) He is simply asserting the right of the estate not to be subject to the demand made against it.

When the receiver appeals from an order which subjects the estate to the satisfaction of any demand, we submit that the manifest weight of authority is conclusive that he comes to the Court of Appeals as the representative of no particular party, *but of the estate*, and in asking the judgment of the Court of Appeals he is asserting the right *not of a party*, but of the estate for the benefit of whomsoever may be ultimately entitled thereto.

This position is adopted by the Court of Appeals when it says of him in this case (opinion, p. 4) that:

> "He has the right to appeal with respect to any claim asserted by or against the estate, for therein he is the representative of the entire estate."

If this is so, then upon what ground was this appeal dismissed? Was it upon the ground that the demand of the intervener is not a claim against the estate?

(i) The claim of the intervener is one asserted solely against the estate.

Can it be seriously contended for one moment that the claim of the Terminal Railroad Association is not one which is asserted against this estate, and *asserted solely against the estate?* In the intervening petition no relief is prayed against the railway company; no relief is prayed against the bondholders, nor the trustee, nor any other creditor; *but the form and substance of the demand is against the estate solely.* The intervening petition seeks no priority over other creditors; it simply asks the court to give it a portion of the estate *and ignores all parties.* (R. p. 26.)

(j) This right to appeal is announced by the two leading text writers on receivers.

At section *264 of High on Receivers*, a text writer who for years has been recognized by the courts of this country as eminent authority on that subject, we find the following:

> "It is held in actions against receivers in their official capacity that they cannot, either expressly or impliedly, waive any legal or equitable defense on which their principal might have relied had the action been brought against him. Receivers of an insurance company cannot, therefore, in an action brought against them to recover upon a policy of insurance issued by the company, waive or dispense with the conditions of the policy as to notice of loss. And although leave may be granted to sue a receiver, he is at liberty to assert any defense which he may have to the action, either by plea, answer or demurrer, *and he has the same right to appeal from an ad-*

verse judgment for the recovery of funds pertaining to this receivership, as the party over whom he was appointed would have had."

On this same subject we find that *Beach*, the other well recognized authority on receivers, at *section 716*, says:

"Every claim presented against a fund in the hands of a receiver, if contested before the court, *becomes in effect a suit against the receiver*, which is ended by final judgment allowing or rejecting the claim, and any party to the contest dissatisfied with the result, may have the proceedings reviewed on appeal. *The receiver, as a party defendant to the action, has the same right to appeal from a judgment of the court affecting the interests of the estate represented by him*, that the party or corporation to whom the estate originally belonged would have had if the suit had been brought against them."

(k) An appeal by a receiver may be a meritorous rather than a censurable act.

High on Receivers, at section 207, says:

"It is important to observe that the general doctrine of courts of equity, recognizing a receiver as the officer or representative of the court from which he derives his appointment, *is not to be understood as limiting or restricting his rights in the management of a suit which he has once undertaken*. And after entering upon the litigation, he is regarded as being entitled to all the freedom of action of any other person, *and the fact that he appeals from a decision which is adverse to him is not of itself evidence of bad faith, or mismanagement of his trust, and may be a meritorious rather than a censurable act.*"

THIRD.

This Action Should Be Determined Upon the Record.

In its opinion at page 4 the Court of Appeals assumes that the estate has passed out of the hands of the receiver since this intervening petition was filed, as it says:

> "The record here is not complete. There has been brought to this Court only so much of the record as is thought to bear upon the particular question which the receiver desired to present. It was, however, conceded at the argument that prior to the decree appealed from the railway had been sold under decree of sale, and had passed out of the possession of the receiver and into the possession of the purchaser, and that the receiver had not in hand any moneys with which to pay the debt adjudged."

We are unable to say how much the conclusion of the Court is based upon the foregoing assumption of facts which do not appear of record. But it is safe to say that that Court would not have inserted the same in its opinion, if it in no way affected its conclusion. We, therefore, feel justified in calling attention to the well-satisfied principle that a court of review in determining any question presented to it will confine itself strictly to the record before it. It is true that those matters were not denied by counsel at the argument, but this Court in *Hook vs. Bosworth, supra.*, said that

although counsel suggested certain facts, yet nevertheless, as they did not appear of record, it could not *assume them to be facts.*

Again, all of these facts assumed by the Court of Appeals must have occurred subsequent to the filing of the intervening petition, and that court has held in *Empire Distilling Company vs. McNulta, 77 Fed. Rep., 700*, that while a petition of intervention need not be as formal as a bill of complaint, yet it should contain all the material facts relied on, and embodying by recital or reference, *so much of the record in the original suit as is essential*; and that proceedings taken in that original suit, after the filing of the petition which woud fortify the right of the intervener, should he incorporated in the petition by amendment, *and if this is not done such proceedings cannot be noticed by an appellate court*, inasmuch as those subsequent proceedings are not properly brought before it on appeal.

The justice of this is at once apparent, for when the subsequent proceedings are made a part of the record, and one party asserts its intention of relying thereon, the other party has an opportunity of meeting in a formal and orderly manner the contentions asserted by the opposing party on account of said subsequent proceedings.

The conclusion which, it is apparent, the Court of Appeals based upon this premise of facts, not disclosed by the record, is found in the following language (Op. p. 5):

> "By what authority may he assert the rights of a purchaser? *By what right does he undertake to prevent the enforcement of this claim against the purchased estate*, presumably by the decree of sale, charged as a lien upon it? He has no such right. He is, in so doing, an interloper, obtruding himself in breach of his duty where he has no right, and in a matter in which he is not concerned, and to sanction such action is to encourage vexatious litigation at the expense of the estate which should be cast upon the interested parties, and to hold out the temptation to a receiver and his counsel to swell the cost of administration by assuming litigation with which he has not the right to interfere."

We submit that this conclusion of the court can be based upon no other premise than the assumption of facts not in this record, viz: *that the only interested party is the purchaser at the foreclosure sale.*

FOURTH.

The Decisions of the State Courts, Relied on by Interventor, Are Based on Facts Not Found in This Record.

In the Court of Appeals, counsel for intervener cited decisions from State courts in support of the proposition that a receiver has not the right of appeal. We have made a brief abstract of those cases for the purpose of showing that the conclusions

reached by those courts are based on a condition of affairs wholly different from that disclosed by the record in this case; and for that reason submit that they have no application to the case at bar.

The court will find, not only that the proceedings, in which those receivers were appointed, were for the dissolution of corporations and the winding up of the affairs of individuals, partnerships and lunatics, but that the receivers were appointed in the first instance for the express purpose of conserving the estate for the benefit of *all* creditors, secured and unsecured, and for the distribution of such estate between them, *pro rata.*

The Court will also find that in two of the citations the receiver's appeal was dismissed on the ground that *he was attempting to offset a claim of his own against the trust estate*, and that the quotation from *Thompson on Corporations*, in which he so positively asserts that receivers have no right of appeal in matters concerning the distribution of the estate, *is based solely on those two cases.*

In *Herrick vs. Miller, 123 Ind., 305*, it appears that Herrick was appointed receiver after a decree of sale had been entered in a suit to foreclose a real estate mortgage. He was appointed for the express purpose of receiving the rents and profits pending the sale and during the year of redemption. The receiver reported

to the Court that up to the date of sale the rents collected amounted to $17.23, claiming credits for $12.40. The Court refused to approve this report, and the receiver then filed another showing in addition, rents collected during the year for redemption to be $92.12. Miller, the complainant in the foreclosure, filed a motion for an order on the receiver to pay the amount over to him. The receiver resisted this motion on the ground that he had bought the property after the foreclosure, and was therefore entitled to the profits earned by the land during the year for redemption. The Court sustained the motion of Miller, and required the receiver to pay over the money. From this the receiver appealed. The real ground upon which that appeal was dismissed is found in the following language of the Court:

> "When ordered to pay the money to any particular person he will not be allowed to offset a claim due to him personally, since to allow this would render the disposition of the money as uncertain as before the receiver's appointment, and would defeat the very object of his appointment."

In that case there was no question as to the priority of rival creditors of an insolvent, to the estate; the real question was whether a receiver could become a purchaser of property pertaining to his trust, and could offset his claim in that behalf against complainant. Everything said by the Court not necessary to that determination is *obiter dicta.*

Stanton vs. Andrews, 18 Ill., App. 552, originated in an intervention filed by Andrews in a creditor's suit. It appeared that all the funds that could be realized from the insolvent judgment debtor had been distributed in pursuance of a stipulation entered into by all the parties interested.

The claim of Andrews was for royalties accruing on work finished by the receiver. The receiver joined issue and on hearing the master found in favor of the petitioner, but his report was overruled by the court, on the sole ground that petitioner should have sued at law instead of intervening in the creditors' suit. From this decree the intervener appealed and in reversing the lower court, the Supreme Court not only sustained the remedy pursued, but also affirmed the claim.

It was then, after the petitioners' right to the amount claimed had been sustained by the higher court, and by agreement of all creditors and parties in interest, a sum had been set apart for satisfying the claim, that the receiver refused to pay it.

The only ground upon which the receiver based his right to contest the allowance was, an order which the lower court entered while the case was pending on the first appeal, setting aside a certain sum to satisfy petitioner's claim, and *providing that the receiver should retain the residue, if any, as additional compensation for his services.*

The court says:

> "It is apparent to us that this action on his part is dictated by that provision of the order of January 4th, 1896, which constructively *gave the receiver a contingent interest* in the sixteen hundred dollars set apart for appellee's claim. We cannot but regard that part of the order as injudicious. It placed the receiver in a position where *his interest was in direct conflict with his duty.*"

So it will be seen that the controlling question in this case was the same as that in *Herrick vs. Miller*, *supra*, viz: that the receiver could not assert a personal claim to the trust property. And in addition we find that the court had marshalled the assets of the insolvent.

Section 6941 of Thompson on Corp. is based *solely* on the two foregoing cases, and is therefore entitled to no more weight, nor to be decisive of any other principle, than they are.

In *3 Md. Ch.* (*Re Colvin*) *278*, a Chancery Court appointed a Committee for a Lunatic. Shortly afterwards the Lunatic died and the court appointed a receiver to take charge of her property pending a litigation over her will. Later on the Orphans' Court appointed an administrator, and the question was, who was entitled to the possession of the property. There was no question of the receiver appealing from any order, distributing the assets in his hands, between rival claimants.

In *Chicago Title and Trust Company vs. Caldwell, 58 Ills. App. 219,* the express object of the original bill was to dissolve an insolvent corporation and distribute its assets *pro rata* among its creditors. The lower court ordered the claim of Caldwell to be allowed against the estate for $850.

> "To be paid *pro rata* with the claims of general creditors, and that the receiver pay to said Caldwell as dividends upon said sum the same percentage thereof as paid upon other claims of unsecured creditors."

The case of *Strauss vs. Carolina Interstate B. & L. Association* we do not find reported at *24 S. E. Rep. 740,* as cited by appellee, and therefore cannot state with accuracy the nature of the proceeding.

Beverly vs. Brooke, 4 Gratt. 208, also appears to be a controversy in which the court was administering the property for the benefit of *all creditors,* and involved no question of a receiver's right to appeal from an order distributing the assets between rival creditors.

In *People vs. Security Life Insurance Company, 79 N. Y. 267,* it appeared that the receiver obtained an order requiring all creditors of the insolvent corporation to exhibit their claims within a specified time. Before the expiration of the time, he addressed a circular to the policy holders to the effect that policies in force on the books of the company would be allowed without subjecting their holders to further

proof; mislead by such circulars the holders did not make further proof of their claim. These were objected to by other creditors, and were accordingly rejected by the referee, to whom the cause was referred to take proof *as to distribution of the assets.* But before any dividend had been made the receiver applied for and obtained an order giving two months further time within which such claims could be presented and established before the referee.

On this state of facts the court says:

> "The learned counsel for the appellants contends that the receiver has no standing in court; that he can be heard only as to his fees and compensation, and had no right to be heard upon the motion which resulted in the order appealed from; and, second, that the court itself had no power to grant the order. *Upon both questions we think he is in error.* Since the receiver is an officer, or as he is sometimes called, 'the hand' of the court, *it would be singular if he could not at any time go to it* with his complaint, *or for instructions in regard to any matter touching the fund placed in his custody, and more especially when,* as in the case before us, *it is in danger,* through his own error, *of being unfairly distributed.* He is not to advocate the cause of one claimant as against another—between them he is indifferent, owing a like duty to all, *and for that very reason* should, as far as possible, see to it that each has an equal opportunity to enforce his claim. *He stands as their representative and is bound to give them reasonable aid.*"

It is not to be forgotten that the above case was cited by intervener to support its contention that a receiver has no right of appeal, and we submit that it sustains the contrary.

Dorsey vs. Seibert, 93 Ala., 312, comes nearer presenting a state of facts similar to the case at bar.

But there is this vital distinction; first, it was a suit by a *general creditor* against the railway company, and therefore the funds arising from its operation *belonged prima facie* to general creditors who might intervene; second, the particular creditors did not intervene until after the property was sold, title made, and proceeds placed in the hands of the receiver for distribution.

It is hardly necessary to say that nothing was further from the mind of counsel than to trouble the Court of Appeals with mere moot questions. *Thom vs. Pittard*, in the light of *Farlow vs. Kelly*, to say nothing of the support found upon full review herein of text writers and adjudicated cases, seem ample justification for the appeal itself in the name of the receiver; and if a receiver's rights in the management of a suit are to be restricted by his being construed as the "hand," and the court which appoints him, as the "head," it follows that "if the order granting the appeal should be treated as permission to appeal," then there is no rebellion of the hand against the head.

In conclusion we, therefore, submit that the weight of authority sustains our contention that in cases in which the courts have taken possession of railroad property upon the application of a mortgagee seeking to foreclose its mortgage, the receiver represents no party but the estate itself, and that it is his duty to resist every attempt on the part of a stranger to diminish the same by depriving him of any portion of

it, and that to retain the fullest possession he has the right to present to the court of last resort for review any decree made by the lower court.

Again, that the repeated recognitions, and sanctions, by this Court of Appeals of this particular receiver's right to appeal, in this particular forecloseure proceeding, justified his appeal in this particular case.

FIFTH.

Before an Unsecured Creditor can Displace a Vested Mortgage Lien, He must Bring Himself Within the Well Defined Rules Laid Down by the Supreme Court.

We contended in the Circuit Court, and in the Court of Appeals, that the intervener was not entitled to a priority in this case, for the reason that there had been no diversion of the current earnings of the railway company, nor a diversion of the income of the receivership, to the benefit of the mortgage bondholders. In fact, the intervener did not rely on such diversion for its right, but rested wholly on the provision in the order appointing the receivers, directing them to make certain payments. This order created no vested right, and each demand must stand or fall on its own merits. From a hasty review of the decisions touching this question, the rights of the parties might not appear to be settled on a definite basis;

but from a thorough analysis of the cases it will clearly appear that the Courts have acted on well defined equitable principles.

(a) The rule giving certain unsecured claims priority over a mortgage lien is founded on diversion.

The practice of postponing the lien of a mortgage on railroad property to the payment of certain unsecured creditors most probably originated in the Seventh Circuit of the Federal Courts. At least it was in that Circuit that such practice first received judicial sanction, after being contested. In its inception this was considered nothing more than a "policy," and not until March, 1879, when the Supreme Court of the United States rendered the decision in the case of *Fosdick vs. Schall,* did it even attain the dignity of a "rule." Since then it has gradually evolved into a doctrine, the general principles of which are now firmly grafted into our equity jurisprudence, although many of the details as to pleading and practice remain to be announced by the Court.

As a policy it has obtained in some jurisdictions since as early as 1850, but merely by sufferance or consent of interested parties. The early history of the financial embarrassments of railroads shows that after being in the hands of a receiver for a short period they were usually turned back to the company,

and through the protection of the Court a foreclosure was actually avoided. Under such circumstances the payment of unsecured creditors worked no hardship to the mortgagees, but materially enhanced the value of their securities, and they had neither reason nor desire to attack the policy.

Later on in the era of railroading, when competition became greater, and success harder to attain, it appeared that such corporations could not recoup their financial standing by merely going into the hands of a receiver; but instead it began to mean a foreclosure, sale, and reorganization. Then it was that the interest of mortgagees began to be affected, and to protect that interest they were compelled to attack this policy.

The first written opinion rendered on this question to be found in the books, is recorded in *8 Bissell, 315*, decided in 1878, wherein Judge Drummond stated the grounds upon which he had sustained the "practice."

It will be seen that in this very first case, (*Turner vs. Indianapolis Railway*), while the right to displace mortgage liens is rested on the general powers vested in the discretion of a chancellor, yet one of the most potent, and the most logical reason for exercising it, is based on the fact that:

> "It was found in many cases that those who had control of the railways, instead of paying the current operating expenses of the companies, would postpone the payment of the same, sometimes for many months, in favor of the interest due on the mortgages, which they would

> discharge, in the hope, apparently, that a more favorable time in the business of the roads would enable them to make up the deficiency."

We have quoted from this case, because it is of no little significance, that in the very origin of this practice is to be found that condition of facts, which we contend should be averred and proved before this doctrine can be applied.

(b) In the illustrative cases diversion is made the test.

In the classification of these decisions, the case of *Fosdick vs. Schall, 99 U. S., 235,* has been often cited as the pioneer, presumably because it is the first recognition of this practice as a doctrine by the Supreme Court, yet, in view of the earlier case of *Turner vs. Indianapolis, Bloomington & Western, supra,* which manifested the existence of the doctrine as a policy, many years prior, we feel justified in classifying *Fosdick vs. Schall* as illustrative. And in this connection it is a curious fact, that although universally cited by claimants in support of their right to displace mortgage liens, the court in this case refused just such relief, because the facts before it would not warrant the application of the doctrine.

Now in this first illustrative case we find that the Supreme Court has selected, from the many reasons assigned by the Circuit Court in *Turner vs. Indianapolis, Bloomington & Western, supra,* the single test

of "diversion," as necessary to be established by the facts and circumstances of each particular case. This is shown in the following language:

> "The business of all railroad companies is done to a greater or less extent on credit. This credit is longer or shorter, as the necessities of the case require; and when companies become pecuniarily embarrassed, it frequently happens that debt for labor, supplies, equipment and improvements are permitted to accumulate, in order that bonded interest may be paid and a disastrous foreclosure postponed, if not altogether avoided. In this way the daily and monthly earnings, which ordinarily should go to pay the daily and monthly expenses, *are kept from those to whom in equity they belong, and used to pay the mortgage debt.* The income out of which the mortgagee is to be paid is the net income obtained by deducting from the gross earnings what is required for necessary operating and managing expenses, proper equipment and useful improvements. Every railroad mortgagee in accepting his security impliedly agrees that the current debts made in the ordinary course of business shall be paid from the current receipts before he has any claim upon the income. If for the convenience of the moment something is taken from what may not improperly be called the current debt fund, and put into that which belongs to the mortgage creditors, it certainly is not inequitable for the court, when asked by the mortgagees to take possession of the future income and hold it for their benefit, to require as a condition of such an order *that what is due from the earnings to the current debt shall be paid by the court* from the future current receipts before anything derived from that source goes to the mortgagees."
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> * * * * * * * * * * * *
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> "We think, also, that if no such order is made when the receiver is appointed, and it appears in the progress of the cause that bonded interest has been paid, additional equipment provided, or lasting and valuable improvements made *out of earnings which ought in equity to have been employed to keep down debt for labor, supplies and the like,* it is within the power of the court to use the income of the receivership to discharge the obligations which, *but for the diversion of funds,* would have been paid in the ordinary

course of business. This, not because the creditors to whom such debts are due have in law a lien upon the mortgaged property or the income, but because, in a sense, the officers of the company are trustees of the earnings for the benefit of the different classes of creditors and the stockholders; *and if they give to one class of creditors that which properly belongs to another, the court may, upon an adjustment of the accounts,* so use the income which comes into its own hands as, if practicable, to *restore the parties to their original equitable rights.*"

* * * * * * * * * * * *

"No fixed and inflexible rule can be laid down for the government of the courts in all cases. Each case will necessarily have its own peculiarities, which must to a greater or less extent influence the Chancellor when he comes to act."

"*The power rests upon the fact,* that in the administration of the affairs of the company *the mortgage creditors have got possession of that which in equity belonged to the whole or a part of the general creditors. Whatever is done, therefore, must be with a view to the restoration by the mortgage creditors of that which they have thus inequitably obtained. It follows that if there has been in reality no diversion, there can be no restortion; and that the amount of restoration should be made to depend upon the amount of the diversion.* If in the exercise of this power errors are committed, they, like others, are open to correction on appeal. All depends upon a proper application of well settled rules of equity jurisprudence to the facts of the case, as established by the evidence."

In the case of *Union Trust Company vs. Souther, 107 U. S. 591,* is to be found another form of diversion which illustrates the fact that no "fixed and inflexible rule has been laid down for the government of courts in all cases," but it is sufficient, yet imperative, that it be shown that the money which should go to the general creditors has been *diverted* to the benefit of the mortgagees. In that case the Court said:

"The income of the receivership, instead of being applied in accordance with the order to pay the debts for the supplies and labor, was used with the consent and, it may fairly be inferred, at the request of the bondholders, to buy additional grounds, rolling stock, etc., and to make permanent improvements, thus adding to the value of the property; which was afterwards sold. There is nothing whatever to indicate that in thus using the income it was the intention of the Court to revoke the original order. It seems to have been found, in the administration of the cause, that by using the income to add to the value of the fixed property, the interests of all parties would be promoted, *and so the fund which in equity belonged to the labor and supply creditors, was for the time being diverted from them and put into improvements and additions, the proceeds of which are now in Court.* It is not to be presumed that this diversion would have been athorized if the value of the property added to and improved was not to correspondingly increase. Clearly therefore, on the face of the transaction, the fund in Court represents in equity *the income which belongs to the labor and supply creditors, as well as the mortgage security,* and there was no impropriety in appropriating it as far as necessary to pay the creditors specially provided for when the receiver was appointed. Such a practice, under proper circumstances, was approved in *Fosdick vs. Schall, ubi supra,* and seems to be eminently just."

In the case of *Wood vs. Trust Company, 128 U. S., 416,* the necessity of showing the diversion is most strongly stated in the following language:

"The argument is unsound. There are several answers to it. First, it overlooks the vital distinction between a debt for construction, and one for operating expenses. The doctrine of *Fosdick vs. Schall* is applicable wholly to the latter class of liabilities. * * * Secondly, it overlooks the important fact that the doctrine only applies where there is a diversion of the income of a 'going concern' from the purpose to which that income is equitably and primarily devoted, viz: the payment of operating expenses of the concern. In other words, the income must be first devoted to the expense of producing

> the income. In this case it is not pretended that the money used in paying the 117 coupons in question was income of the water works company."

Again, in *Burnham vs. Bowen, 111 U. S., 776, it was contended on behalf of the bondholders that* "no part of the income before the appointment of the receiver, was used to pay mortgage interest or to put permanent improvements on the property, or to increase the equipment, there was no such diversion of the funds, belonging in equity to the labor and supply creditors, as to make it proper to use the income of the receivership to pay them." And before the Court decided that the vested lien could be displaced, *it found there had been such a "diversion."* The Court there said:

> "When, therefore, the Court took the earnings of the receivership and applied them to the payment of the fixed charges on the railroad structures, thus increasing the security of the bondholders at the expense of the labor and supply creditors, *there was such a diversion of what is denominated in Fosdick vs. Schall the "current debt fund," as* to make it proper to require the mortgagees to pay it back."
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> * * * * * * * * * * * * *
>
> "We do not now hold any more than we did in *Fosdick vs. Schall, or Huidekoper vs. Locomotive Works, 99 U. S., 260,* that the income of a railroad in the hands of a receiver, for the benefit of the mortgage creditors who have a lien upon it under their mortgage, can be taken away from them and used to pay the general creditors of the road. *All we then decided, and all we now decide is, that if the current earnings are used for the benefit of the mortgage creditors before current expenses are paid,* the mortgage security is chargeable in equity with the restoration of the fund which has been thus improperly applied to their use."

In the case of *Farmers' Loan and Trust Company vs. Green Bay Railway, 45 Fed. Rep., 664*, it was sought to postpone the lien of the mortgage in favor of a claim against the railway company for causing death of petitioner's intestate. There Mr. Justice Jenkins, in disallowing the claim, stated the principle as follows:

> "The principle upon which equity acts in disallowing certain claims, priority of payment over precedent mortgage in the case of railways is settled by repeated adjudication of the Supreme Court. The gross income arising from the operation of a railway should be first applied to the payment of the expense of operation, proper equipment, and needful improvements. If the income be diverted to the payment of bonded interests, in disregard to the payment of such expenses, there should be restoration to original equitable right. Failing diversion, there can be no restoration. The amount of restoration is dependent upon the amount of diversion. The power rests upon the fact of diverson of a fund belonging in equity to the general creditors, or some of them."

In the case of *American Loan and Trust Company vs. Railroad Company, 46 Fed. Rep., 101*, in disallowing a claim for construction, the court, at page 104, said:

> "Finally in the case of *Wood vs. Deposit Company, 128 U. S., 421*, the Supreme Court expressly declares that 'the doctrine of *Fosdick vs. Schall* is applicable wholly to debts incurred for operating expenses, and does not apply where it is a question of original construction, and further, that it only applies where there is a diversion of the income of a going concern from the parties to which that income is equitably and primarily devoted.' It does not appear from the record in this case, nor otherwise, that prior to the receivership there was any diversion of current earnings or funds which should have been applied to the payment of intervener's claim, to the payment of interest on the bonded debt, or any diversion whatever

> of any earnings of the property which should have been applied to the payment of intervener's claim."

Again is this test of *diversion* recognized and applied in the case of *Union Trust Company vs. Illinois Midland Railway Company, 117 U. S., 432*, where, at page 479-80, the court says:

> "The commissioner and the Circuit Court rested the allowance of these certificates on what was said by this court in the case of *Fosdick vs. Schall, 99 U. S., 235, 253, 254*, which views were applied in *Burnham vs. Bowen, 111 U. S., 776*, to the effect that when the current income of a railroad in the hands of a receiver *is diverted to the improvement* of the property by the receiver, and debts for operating expenses are not paid, provision should be made, in foreclosing a mortgage on the road, to pay such debts out of the proceeds of the sale of the property. See also *Union Trust Company vs. Souther, 107 U. S., 591.*"

(c) The only other cases in which a mortgage lien has been postponed are those in which the doctrine of estoppel is applicable.

We do not desire to have the court understand us as contending that diversion is *absolutely the only ground* upon which rests this power of a court of equity to diplace mortgage liens in favor of unsecured creditors in cases of insolvent railroads. Our argument has so far been made solely with reference to the facts in this particular case. We are acquainted with that other class of cases in which priorities are based on the doctrine of estoppel.

We also are aware that some text writers have attempted to add still another ground upon which to rest this power, making in all, three—"Diversion of Income," "Estoppel," and "Necessity." We submit, however, that a close analysis of the decisions will show "Necessity" to be simply one of the elements of "Estoppel," and that the two are really the component parts of one.

Simply for the purpose of distinguishing between the case at bar, and those based on estoppel, we desire to call the Court's attention to a few leading cases illustrative of the latter.

In *Farmers Loan & Trust Co., vs. Green Bay Co., 45 Fed. Rep., 664,* the Court, after stating the doctrine based on the diversion of income, said:

> "The exercise of this equitable power in the Court is not, however, dependent solely upon diversion of current earnings to payment of bonded interest, leaving current expenses unpaid, but is exercised as well in consideration of the fact that, *in case of failure of the trustees to take possession upon default,* it is indispensable to the preservation of the property that it should be operated. It must be kept a going concern. The expense of such operation and maintenance within a limited time prior to the receivership is therefore allowed priority."

In *Union Trust Company vs. Souther, 107 U. S. 591,* this Court said:

> "The right to impose terms does not depend alone on whether current earnings have been used to pay the mortgage debt, principle and interest, instead of current expenses. * * * * Many other considerations may make such order reasonable, and this case furnishes a direct

> example. The first default in the payment of interest under the mortgage occurred in October, 1873. The bondholders did not see fit to take possession, which they had the right to do when the default had continued six months. On the contrary, notwithstanding, no payments of interest were made, they allowed the company to operate the road and incur obligations therefor, until December, 1877. This was evidently in the hope that their condition would be improved by the delay. * * * * There cannot be a doubt that it was for the interests of the bondholders that the road should be kept in operation, and as they did not see fit to take possession while it could only be operated at a loss, it was certainly not an abuse of judicial discretion for the Court to order as the condition of granting the application for a receiver, that debts incurred by the company in thus procuring their credit, should be paid from the income of the receivership."

Again in *Burnham vs. Bowen, 111 U. S. 776*, the mortgage bondholders were never paid any interest, but the company was allowed to remain in possession and operate the road for a number of years. By reason of that fact this Court there said:

> "The debt due Bowen was incurred to keep the road running, and thus preserve the security of the bond creditors. If the trustees had taken possession under the mortgage, they would have been subjected to similiar expenses to do what the company, with their consent and approbation, was doing for them."

It is to be observed that the cases in which the question of "Necessity" is most discussed and which text writers cite as supporting "Necessity" as a distinct ground upon which to rest this power, are cases in which the trustee had failed to take possession upon default in interest; and that the "Necessity" referred to is that of keeping the railroad a going concern *during the period the trustee failed to act*. This neces-

sity of course is two fold; first, to serve the public and, second, to preserve the mortgage security. But behind both is the fact that during the time at which this necessity existed, the trustee permitted the railway company to do what it would have had to do had it taken possession of the property, viz: to meet these necessities by incurring obligations for the operation of the property during that time. In other words, that the trustee by remaining inactive led the general creditors to believe that the interest was being paid, and thus permitted the company to become its agent for the operation of the road. It is, therefore, that we contend that the whole reasoning is comprehended by the single ground of "Estoppel."

(d) **The doctrine of estoppel can not be applied to the case at bar.**

In this case the trustee procured the Circuit Court to take pessession of the property twenty days after default in the payment of interest, (R. pp. 5 and 22) and we feel justified in asserting that it would be impossible, except upon preconcerted plans adopted by both the trustee and railway company, for a trustee to be more active in seeking remedy than this one was. On this question Judge Jenkins said in *Farmers' Loan and Trust vs. Green Bay, supra:*

> "The bonds of American railways are scattered throughout Europe, and are held in many hands. It requires much time to institute concerted action by the holders after default in the payment of interest."

In *Union Trust Co. vs. Souther, supra*, the bondholders did not see fit to take possession until four years after default, and in *Burnham vs. Bowen, supra*, the trust deed was executed in June, 1871, and "no interest was paid on these bonds, but the company remained in peaceable possession and operated its road until the early part of the year 1875," when suit to foreclose was begun. So in all these "estoppel" cases it will be found that the time during which the trustee failed to act is not measured by days, but by months and years. For this reason we are hardly justified in anticipating that opposing counsel will contend that the doctrine of estoppel can be applied to the case at bar.

(e) If the right of recovery depends on diversion, the same must be alleged and proved.

In *Fosdick vs. Schall, supra*, this Court said:

> "All depends upon a proper application of well settled rules of equity jurisprudence to the facts of the case, as established by the evidence."

If, therefore, the facts which constitute the diversion have not been alleged, how can a Court apply the rules of equity jurisprudence and grant relief?

(f) Where there has been no diversion there can be no restoration.

Did this Court mean absolutely nothing when it said in *Fosdick vs. Schall*, that "it follows that if

there has been in reality no diversion, there can be no restoration;" and when again in *Burnham vs. Bowen* in reaffirming and construing *Fosdick vs. Schall*, it said: "All we then decided, and all we now decide is, that IF the current earnings are used for the benefit of the mortgage creditors before current expenses are paid, the mortgage security is chargeable in equity with the *restoration* of the fund which has thus been *improperly applied* to their use;" and when in the very late case of *St. Louis Railway Company vs. Cleveland Railway Company, 125 U. S., 658*, after referring to almost every case which it had decided touching this question, it again said:

> "The rule governing in all these cases was stated by Chief Justice Waite in *Burnham vs. Bowen;* as follows: 'That IF the current earnings are used for the benefit of the mortgage creditors, * * * the mortgage security is chargeable in equity with the restoration of the fund which has been thus improperly applied to their use.' *There has been no departure from this rule in any of the cases cited. It has been adhered to and reaffirmed in them all.*"

Thus always has the diversion been made the condition precedent to the restoration, and it follows unquestionably that unless there has been a diversion there can be no restoration.

(g) **If the amount of restoration depends upon the amount of diversion, how can relief be granted unless the latter is alleged and proved?**

That the *amount of restoration* does depend upon the *amount of diversion* was announced in the earliest

case, when, in *Fosdick vs. Schall*, the Supreme Court said:

> "What is done, therefore, must be with a view to a *restoration* by the mortgage creditors of that which they have inequitably obtained. *It follows that if there has been in reality no diversion there can be no restoration; and that the amount of restoration should be made to depend upon the amount of diversion.*"

In the case of *St. Louis, Alton & Terre Haute Railway vs. C., C., C. & I. Railway, 125 U. S., 658*, this court announces that it is absolutely necessary to prove a diversion before the mortgage lien can be postponed. There the propositions on which counsel for intervening petitioner based its right to the relief prayed for are stated as follows:

> 1. "Because it is an *unpaid operating expense* of the Indianapolis and St. Louis Railroad Company, there having been gross earnings abundant to pay all operating expenses, including the rent of the leased line.
>
> 2. Because it is a debt justly due to the petitioner *as a connecting line.*
>
> 3. Because gross earnings lawfully applicable only to operating expenses, until every operating expense has been fully paid, have been diverted to the benefit of the bondholders of the petitioner in payment of bonded interest, and in adding increased value to the mortgaged property by additions and improvements, to an amount sufficient to have paid the debt, now due to the petitioner, many times."

In that case the petitioner attempted to show a diversion, and, considering the propositions relied upon by it, in connection with the facts established by the evidence, this court said:

"But none of these reasons, standing by themselves, are sufficient. It is undoubtedly true that operating expenses, debts due to connecting lines growing out of an interchange of business, and debts due for the use and occupation of leased lines, are chargeable upon gross income before that net revenue arises which constitutes the fund applicable to the payment of the interest on mortgage bonds. But here there is no question in respect to current income. The fund in court is the proceeds of the sale of the property, and represents its *corpus;* and it can not be claimed that ordinarily the unsecured debts of an insolvent railroad company can take precedence in the distribution of the proceeds of a sale of the property itself over those creditors who are secured by prior and express liens."

"There are cases, it is true, where, owing to the special circumstances, an equity arises in favor of certain creditors of an insolvent railroad corporation, otherwise unsecured, by which they are entitled to outrank in priority of payment, even upon a distribution of the proceeds of a sale of the body of the property, those who are secured by prior mortgage liens. Illustrations and instances of these cases are found in *Fosdick vs. Schall, 99 U. S., 235*; *Miltenberger vs. Logansport, C. & S. W. R. Co., 106 U. S., 286; Union Trust Company vs. Souther, 107 U. S., 591*; *Burnham vs. Bowen, 111 U. S., 776; Union Trust Company vs. Illinois Midland Railway Company, 117 U. S., 434; Dow vs. Memphis & L. R. R. Co., 124 U. S., 652; Sage vs. Memphis & L. R. R. Co. 125 U. S., 361; and Union Trust Company vs. Morrison, 125 U. S., 591.* The rule governing in all these cases was cited by Chief Justice Waite in *Burnham vs. Bowen, 111 U. S., 776, 783*, as follows: 'That if current earnings are used for the benefit of mortgage creditors before current expenses are paid, the mortgage security is chargeable in equity with the restoration of the fund which has thus been improperly applied to their use.' *There has been no departure from this rule in any of the cases cited. It has been adhered to and reaffirmed in them all.*"

"Admitting, therefore, that the reasonable rent of the leased line accruing to the petitioner was a proper charge upon the gross income of the Indianapolis & St. Louis Railroad Company, as a part of its current operating expenses, before any net income could arise applicable to the payment of the interest on the mortgage bonds,

> *it must still be shown to entitle the petitioner to the relief prayed for, that the arrearage due on account thereof has arisen by the diversion and misappropriation of the fund that ought to have been applied to its payment for the use and benefit of the mortgage bondholders.* Counsel for the petitioner undertake to do this, and insist that upon the proofs in this case it satisfactorily appears that such a diversion and misappropriation have taken place to its injury and to the advantage and benefit of the bondholders claiming the fund in Court for distribution."

The Court then examines carefully the alleged diversions and misappropriations, and finding that there has been no diversion proved, decrees that there is nothing to be restored. We submit that even if this case stood by itself it would be absolutely conclusive of the necessity of alleging and proving a diversion.

SIXTH.

Appellee Relies Solely on the Order Appointing the Receivers for Its Right to Priority.

The *only ground* relied on by appellee for its right to the relief sought, is that its claim "may be allowed and ordered to be paid *under the order of the Court heretofore made herein* directing the payment by the receiver of debts incurred by the Chicago, Peoria & St. Louis Railway Company within six months prior to the appointment of the receiver. (R. p. 26.)

The order appointing the receivers authorized them to "collect and receive the tolls, rents, moneys, issues

and profits of said premises and property as covered by this order, and out of the same they shall put, maintain and keep said property in good repair, and shall further pay," among other things, "all claims for materials and supplies which have been incurred in the operation and maintenance of said property during the six months last past."

(a) That order created no vested right.

Admitting, *arguendo*, that the claim in this case is for "materials and supplies furnished within the six months, and, therefore, comes clearly within the order appointing the receivers and directing them to make certain payments, we submit that that in itself could in no way affect either this particular petitioner's right of recovery, or a valid defense which might exist to the claim. In the very first place, the order appointing the receivers is interlocutory, not final; cannot be appealed from, and therefore, may be modified.

On the other hand, in support of the proposition, that the order of the Court is sufficient to establish and administer principles of equity, it has often been contended, that a court in appointing receivers has a right to impose conditions, and having done so, if the mortgagees take no action to prevent the full operation of the order, they may be considered as having acquiesced therein, and are thereby bound.

Curiously enough also, this contention has its basis in the language used by Chief Justice Waite in the case of ***Fosdick vs Schall, supra,*** which, if it stood by itself, might go far to make the contention plausible. Fortunately, though in this very same case we find the Chancellor limiting and modifying that assertion by language incapable of but one construction. After discussing the ordinary way in which receivers of railroads are usually appointed, and the composition of the order to be entered at that time, he goes further and says that although each case will necessarily have its own peculiarities, yet as the power to make these payments rests upon a diversion, that:

> "Whatever is done, therefore, must be with a view to a restoration by the mortgage creditors of that which they have thus inequitably obtained. It follows that if there has been in reality no diversion there can be no restoration; and that the amount of restoration should be made to depend upon the amount of diversion. If in the exercise of this power, *errors are committed*, they, like others, are open to correction on appeal. *All depends upon the proper application of well settled* rules of equity jurisprudence to the facts of the case, as established by the evidence."

From the above it is plain that the order appointing the receiver is not intended to adjudicate claims upon which no evidence has been introduced. As the court says, if any errors are committed they are open to correction on appeal. Now, inasmuch as an appeal does not lie from an interlocutory order, we can not assume that the Supreme Court intended an appeal from the order appointing the receiver, for such con-

struction of its language would be meaningless. The only appeal which could have been contemplated is an appeal from a final order entered in the prosecution of each specific claim upon which sufficient evidence has been produced to allow the court to act intelligently thereon.

While the courts may have attempted in earlier adjudications to announce as a principle, that a chancellor has the right to make a receivership conditioned on the payment of certain claims; latterly, they have taken great pains to denounce it as utterly unsound. In *Kneeland vs. Trust Company, 136 U. S.*, this court said:

> "When the court appoints a receiver of railroad property *it has no right to make that receivership conditional on the payment of other than those few unsecured claims which by the rulings of this court have been declared to have an equitable priority.*"

This same question was before the Court of Appeals on the same order in the case of *Mather Humane Company vs. Anderson and Bosworth, 76 Fed. Rep., 164.* There, as here, petitioner relied on the order of the court appointing the receivers for its right to payment, and the court, in disposing of that contention, said:

> "Car rentals are not 'materials and supplies,' and besides, *the order being in that respect interlocutory, is not controlling of the subsequent action of the court. It created no vested right, and if wrong, was to be disregarded.*"

(b) Each case depends upon the proper application of well settled rules of equity to the facts as established by the evidence.

That this construction is the only logical one is supported by the last sentence in the above quotation from *Fosdick vs. Schall*, where the court, as though to leave no doubt, says: "All depends upon the proper application of well settled rules of equity jurisprudence *to the facts of the case, as established by the evidence.*" As to this it is sufficient to say, that it is a well settled practice that upon the appointment of a receiver no evidence is introduced as to claims which have accrued in the six months preceding. Of its very nature such a thing is impossible.

The above construction, that each case must depend upon the evidence introduced to support it, and not merely upon the order appointing the receiver, has been announced in *Trust Company vs. St. Louis Railroad, 41 Federal Reporter, at page 552*, where it is said:

> "Circuit Judge Brewer appointed a receiver and directed 'that the said receiver pay, out of any income or revenue which may come into his hands, all just claims and accounts for labor, supplies, professional services * * * that have been earned or matured within six months prior to the date of this order.' *This order was not intended to be final. Its purpose was to confer on the receiver a present authority to pay wages due employes and such like claims, the payment of which ought not to be delayed. The final order to be made on the subject was left for future action.*"

Can it be contended, then, that the order which is usually entered on the appointment of receivers is to be taken as final and conclusive? We say not. On the contrary, we insist that it is simply arming the receiver with the power which would be necessary to preserve the property as a "going concern" while in his custody if the persons to whom that class of debts are due from the railroad company should refuse to continue in the employment of the receiver unless their claims were paid. It simply vests in the receiver the authority to pay those claims, if in his judgment their payment is necessary and indispensable to the maintenance of the property under the receivership.

Again in *Blair vs. St. Louis Railroad, 22 Federal Reporter, at page 474*, the court said:

> "It is true that the court, as a condition of the appointment of a receiver, may, in his discretion, require the payment of certain claims, *but that discretion is not an arbitrary one.* It may not require the payment of any claims that it desires, *but only such claims as it is equitable should be paid*—that in equity are paramount to those of the mortgages, *and if it is equitable that these claims should be paid prior to the mortgage debt, then what difference can there be in the mere making of an order therefor? In all cases the payment of such claims rests on the fact that it is equitable that they should be paid, and ofttimes this equity can only be determined upon a full investigation into their nature—an investigation which cannot be had at the time the receiver is appointed.*"

SEVENTH.

The Facts Established by this Record will not Warrant the Application of any well Settled Rule of Equity for the Displacement of a Vested Lien.

The only evidence introduced was the testimony of Mr. Hinchcliffe, Auditor for the Receiver, to prove that the items enumerated in the exhibit to the intervening petition were correct. (R. pp. 38-39.) There is no controversy about this. We admit that the exhibit is a correct statement of the materials furnished and labor performed within the "six months," and also that the amounts are the reasonable value of the same. True, Mr. Hinchcliffe also said: "It is a correct statement of the account payable within the six months rule." But we hardly think a court would consider such a statement as evidence, for it is simply a conclusion of law, and Mr. Hinchcliffe was not sworn as an "expert on law." The most that can *properly* be deduced from it is that the items accrued within the six months.

(a) On the Theory of Diversion, no evidence was introduced to prove:

Generally.

That the mortgage bondholders had obtained possession of that, "which in equity belonged to the

whole or a part of the general creditors," or to appellee; nor

Specifically.

(1) For Recovery out of the income of the Receivership: That the income arising from the current earnings of the railway company was diverted from the payment of current expenses to the payment of the mortgage debt, principal or interest; nor

(2) For Recovery out of the *corpus* of the Mortgaged Premises: That the net income arising from the operation of the property by the receiver, after paying all necessary operating expenses, was diverted from the payment of the claims of general creditors to the betterment of the mortgaged property.

(b) **On the Theory of Estoppel, no evidence was introduced to prove:**

That the trustee of the mortgage bondholders failed, for an unreasonable time after the default in the payment of interest, to move the court to take possession of the mortgaged premises.

CONCLUSION.

We therefore submit that the questions involved in this record are not only important, but that the Court of Appeals is at variance with other Courts of Appeals in the decision rendered by it herein, and that a Writ of Certiorari should issue to review said decision.

We also submit, that if the Writ of Certiorari is allowed, the decision of the Court of Appeals should be reversed and the intervening petition of the Terminal Railroad Association dismissed at its cost.

Respectfully submitted,

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